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5-27-82

Tom Thorne:

Attached is the memo I mentioned. You will see the suggestion in it of radical debt restructuring and other economic steps for a model country.

Frank and I wondered if an analysis could be made of the numbers and implications of one or more such model countries, i.e., what would the debt reschedule look like, what would be the likely capital requirements for other parts of the package, etc. Perhaps Sudan plus Senegal, Zambia and/or Liberia. This would not be a definitive model, just some suggestive indications of the effect in terms of lowered debt schedule and capital needs, etc.

Princeton

DEPARTMENT OF STATE

Washington, D.C.

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May 26, 1982

**MEMORANDUM**

TO: The File

FROM: AF - Frank Wisner
Princeton Lyman

SUBJECT: Addressing the Economic Crisis in Africa

In our meeting with Lehman Bros. Kuhn Loeb, May 25, the outline of a model and process for addressing the current economic crisis emerged. It coincided with lines we in AF were already following but highlighted the importance of certain sequential steps as well as some of the sensitivities of which we must be aware.

Lehman Brothers representatives (Vincent May, Head of Banking Division; Henry Breck, Managing Director; Richard Holbrook; and Theodore Roosevelt IV) all agreed on the seriousness of the crisis. They felt that much of the debt in Africa was virtually unrepayable, but that the various creditors, public and private -- for their own reasons -- engaged in devices to mask that fact (Paris and London Club agreements that were not viable and which added to the interest schedule). Prospects for a rise in commodity prices are not good. Should there be such a rise (or renewed major worldwide inflation), the present system would respond with additional lending to these countries that would only compound the crisis during the next downturn. They agreed to the need for a more fundamental restructuring, but they cautioned that commercial banks would be extremely sensitive to any approach which seemed to imply that the banks had made poor loans and/or were being singled out for criticism. They emphasized therefore a step-by-step approach, starting within the USG. They also proposed that any major restructuring be done first in one country as a model. That country would need to be willing and able to carry out the total package of policy and operational changes involved. It should also enjoy a reputation for good economic policy performance or exhibit a strong commitment to such performance in the future.

Developing Consensus on a New Approach

The steps that were deemed essential to developing consensus for a major new approach to the problem were, in order:

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1. State-Treasury agreement on both the nature of the problem and the basic approach to be taken in addressing it. This was seen as perhaps the most difficult step, but an essential first step before going further. (Consistent with AF/EB/AID memo now going forward).

2. Agreement within the USG on the approach, to include State, Treasury, AID and perhaps Federal Reserve Board plus Ex-Im Bank and OPIC.

3. U.S. agreement with the IMF and IBRD on the problem and approach. Starting point might be that IMF has been asked to take on too much of the burden, and that more governments and institutions, and more resources, were needed to accomplish mutual objectives.

4. Parallel with #3, USG should proceed with consultations with the commercial banks. One-on-one consultations (e.g., Hormats) should precede any group meetings or dinners. Care must be taken to avoid finger-pointing, and to build assurance of a joint approach that would affect (and protect) all banks equally. Influential retired bankers, like David Rockefeller, may be key at the beginning.

5. Consultations with the Congress on the need for and implications of major debt rescheduling.

6. USG-European consultations to agree on new approach and selection of model country or countries. European cooperation will be key on debt question as well as because of their having, as in the franc zone, special banking and credit arrangements in Africa.

7. US/European consultations with Japan. Japan is most unlikely to take the lead on any of these matters, but is a major potential source of new concessional assistance. Japanese input is thus a critical part of a total package which would include both massive debt rescheduling and supply of fresh new capital for imports and development projects.

## The Model

One or more countries would be selected as the model for a new approach. In effect, the model would establish the equivalent of an international mechanism to address bankruptcy of a country. The model would not be dissimilar from the process of placing a company in receivership, i.e., the objective would be to reorder its financial/economic structure in a way that would permit it to continue to do business and regain a position of economic health. (A company in receivership can even borrow again, under controlled conditions). Most importantly, like a company in receivership, the country would agree to economic restrictions and conditions.

The model would have the following elements:

1. Major debt rescheduling, i.e., converting both public and private debts to long-term (e.g., 30-40 year) low-interest loans. These might be new certificates of debt which would have priority demand on receipts.

2. Strict conditionality related to economic and fiscal policy and management.

3. Closely monitored borrowing, both public and private, to include project lending, supplier credits, etc. Borrowing would be approved for specific activities only, and up to specified limits.

4. An agreed, multi-donor, development program to include both project and non-project assistance and pledges of new ODA, with coordination and agreement on the financing of any major new projects (dams, refineries, etc.) in order to control future recurring costs and budgetary demands.

5. (Suggested, but politically difficult), international management of customs receipts and other major parts of the fiscal machinery to assure creditors of payment. Alternatively international private/public control could be extended to key productive assets (e.g., restructuring the ownership/management of Gecamines in Zaire).

## Conclusion

It was recognized that there were few if any African governments which had the strength of political leadership and breadth of institutional capacity to agree and carry through on such a model. But it was also agreed that Africa's economic crisis was particularly acute because of the heavy dependence on commodity exports and lack of much other productive capacity; hence Africa's problems were chronic and demanded this kind of major restructuring. The above scenario thus seemed essential for us to pursue.

5/26/82